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Financial Markets

Irving Trust

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The FOMC report issued by the Fed last Friday (Nov. 18) contained elements of surprise for most financial markets participants. Notably, the Fed eased policy. This, however, was no great surprise to a market that had seen Fed funds fall from 9 3/4% to around 9 1/8%. What is surprising is the discovery that the Fed had eased its policy in the inter-meeting period between Aug. 23 and Oct. 4. Moreover, the Fed had eased by Oct.7, when it released the notes on the Aug. 23 meeting, but it chose not to tell us about this easing until Nov. 18. Why did the Fed wait so long to tell us this, and why haven't the markets reacted better to news that the Fed has eased?

Earlier this year, the Fed had announced that a special telephone conference had been arranged by the FOMC, and that the conference had resulted in a decision to tighten policy modestly. That special conference fell on June 23, and its occurrence was announced to the public on July 15 (three weeks later), when the FOMC report for the May 24 meeting was published. In view of this precedent, the Fed's making us wait at least seven weeks is interesting. Also the Fed failed to pinpoint the date when the easing began. One can infer from the late disclosure that the Fed was not very aggressive in its move, since it masked its actions for as long as possible.

A study of the reserve data for the inter-meeting period is not very helpful in pinpointing the date of the easing. Indeed, the largest swing in weekly Fed funds rates (aside from clear quarter-end pressures) occurred in the very week when the August meeting was held (minus 26 basis points)! However, the week ended Sept. 7 showed the first net free reserve figure we had seen in a long time, so it likely marks the point of easier policy. From then on (except the week ended Sept 21, when technical tax payment problems boosted net borrowings over $1 billion), the net borrowed positions generally declined. The reduction of day-to-day reserve pressure by the Fed was, however, very modest, and the weekly net borrowed/free statistics were erratic, settling down only after the Oct. 4 meeting at which no policy change was made.

Yet the markets' failure to pounce on this good news of easing and rally has strong roots in reality. Reserve data for the most recent two weeks make policy look much tighter than it has been since late August. Possibly the Fed has encouraged rates down as low as it intends. It appears to have miscalculated in its assessment of when the economy would cool off. Fed justification for easing in mid-September was that growth in the economy was moderating. But third-quarter GNP came in at 7.9% (7.7% revised). I don't think the Committee had expected growth to be that strong. The FOMC seems to have stumbled in trying to anticipate the start of a weakening in the pace of the expansion. Now that the economy seems so resilient, the Fed must consider whether it should hold rates here or encourage further declines. Recent reserve figures are harbingers of a rate plateau; but the market is holding. It remains--properly--cautiously optimistic.

Robert A. Brusca

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Market Yields

	11/25/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	11.50%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	9.00
Federal Funds	9.25	9.25	8.25
Repurchase Agreements	8.88	9.00	8.25
U.S. Treasury Issues			
Bills			
3 months	9.11	9.15	8.25
6 months	9.48	9.56	8.68
1 year	10.11	9.87	9.08
Coupons			
2 years	10.50	10.66	9.79
4 years	11.13	11.20	10.35
7 years	11.50	11.64	10.69
10 years	11.75	11.72	10.58
Long Bond	12.00	11.80	10.50
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.20	9.30	8.40
3 months	9.25	9.45	8.60
6 months	9.45	9.60	8.95
1 year	10.05	10.05	9.30
Banker's Acceptances			
1 month	9.20	9.35	8.40
3 months	9.35	9.47	8.65
6 months	9.47	9.65	8.95
Eurodollar Deposits			
1 month	9.50	9.63	9.00
2 months	9.81	9.94	9.50
3 months	9.88	10.00	9.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.01	9.19	8.26
1 month	9.25	9.33	8.42
3 months	9.44	9.49	8.68
Bank Holding Companies			
1 month	9.30	8.94	8.42
Dealer Placed:			
3 months	9.39	9.47	8.41
New AA Corporate Utility Bond	12.90	13.00	11.95
Tax Exempt			
6 month Project Notes	5.45	5.35	4.55
1 year AAA Bond	5.50	5.50	5.25
5 year AAA Bond	7.25	7.20	7.30
20 year AAA Bond	9.40	9.35	9.00

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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